ME/6874/19: ANTICIPATED ACQUISITION BY

YORKSHIRE PURCHASING ORGANISATION OF FINDEL EDUCATION LIMITED

PARTIES' RESPONSE TO THE PHASE 1 DECISION OF 19 JUNE 2020

The Council of the City of Wakefield, acting in its capacity as the lead authority of the joint committee known as the Yorkshire Purchasing Organisation (**YPO**) entered into an agreement with Studio Retail Group plc on 15 December 2019 to acquire, on trust for the other Founder Members of YPO, the entire share capital of Findel Education Limited (**Findel**) (the **Merger**). On 30 June 2020 the CMA decided to refer the merger for a Phase 2 investigation.

This submission sets out the parties' initial response to the CMA's Phase 1 decision of 19 June 2020 (the **Phase 1 Decision**) in which the CMA concluded that it is or may be the case that the Acquisition may be expected to result in a substantial lessening of competition (**SLC**) as a result of both horizontal unilateral effects and horizontal coordinated effects in the supply of educational resources to Educational Institutions in the UK by Generalist Distributors. This submission does not repeat prior submissions made over the course of Phase 1, or attempt to address every aspect of the Phase 1 Decision, but rather lays out the key themes that will need to be addressed over the course of Phase 2, where more in-depth review is possible.

The parties' consider the Phase 1 Decision to be misconceived and unfounded on the evidence. They look forward to engaging in more depth with the CMA in Phase 2, to demonstrate that this merger takes place in an increasingly competitive market experiencing profound change, with a wide range of market participants and will only bring benefits to customers, bringing together YPO's and Findel's complementary businesses enabling a combined YPO/Findel to innovate, improve range and service, whilst driving efficiency to keep low prices.

Executive Summary

- YPO is an organisation with public sector values at its heart that was formed to deliver for its communities, but to do this successfully and deliver on its values, it has to operate efficiently and effectively in its markets, managing the YPO business competitively to drive value and innovation. Its incentive to keep prices low does not only come from YPO's public sector ethos or formal obligations as a public body, but also the interests of its local authority members who need YPO to be low cost and efficient, making sure value is delivered to schools and communities and so allowing them to manage their increasingly stretched budgets.

- The acquisition of Findel would allow YPO to make a step change in meeting increasing challenges in the market and deliver enhanced value much more quickly. Contrary to the selective quotes the CMA has chosen, YPO's case for the Merger shows no expectation of an ability to increase prices or compromise services as a consequence of the Merger, but rather, the imperative to improve financial performance which would be realised through the efficiencies to be gained through the Merger.

- The Phase 1 Decision adopts an implausibly narrow frame of reference, rejecting a very wide range of suppliers as forming either in-market or out of market constraints. These suppliers and the constraints they impose are discussed further below. Crucially, all these suppliers sell the same kinds of products, to the same educational establishments in the UK, for the same uses as the products sold by the Parties.

- Consequently, for the unilateral effects theory of harm set out in the Phase 1 Decision to be plausible, it is critical that customers buy primarily on a "one stop shop" basis, and that the boundary between core purchases and other purchases is fixed. Unless a supplier can charge different prices for purchases made as part of ‘one stop shops’ and purchases made as ‘top up shops’, then competition for top up purchases will constrain all prices. The greater the proportion of top up purchases, the stronger this constraint will be, since the supplier does not want to risk losing a non-trivial share of volumes by pricing higher to exploit the demand for a ‘one stop shop’. However, neither of these assumptions hold true on the evidence.

- The Phase 1 Decision mischaracterises customers as 'sticky' and incapable/lacking motivation to 'shop around'. It also overstates customer reliance on 'one-stop shop' distributors, dismissing the Parties' data which demonstrates that:

    - <u>a large number of customers purchase from a small number of product categories</u>. Almost half of YPO’s customers purchased only one or two categories within the same month in 2019. Over the last four years, the share of customers purchasing at most two categories in the same month has increased from ✂% in 2016 to ✂% in 2019. ✂ of Findel’s customers purchased only one or two categories. Similarly to YPO, the share of Findel’s customers purchasing at most two categories within the same month has increased since 2016 (from ✂% in 2016 to ✂% in 2019). These results are also representative of the position for the Parties’ largest customers;

    - <u>there is variation in the preferences for categories when only a few categories are bought</u>. A material proportion of the Parties’ customers purchase only one category at a time. Furthermore, customers purchasing one category do not have strong preferences for specific product categories. Thus, specialist suppliers offering single product categories can compete with the Parties independently on the specific product category they supply; and

    - <u>customers change their purchasing behaviour from one year to the next</u>. ✂% of YPO’s and ✂% of Findel’s customers in 2018 decreased their spending with YPO and Findel respectively by at least 30% or stopped purchasing from the Parties in 2019. ✂% of YPO’s and ✂% of Findel’s customers in 2018 did not purchase any product from YPO/Findel (as relevant) in 2019. If customers were sticky, expenditure would be expected to be much more stable from one year to the next.

- The CMA has <u>failed to provide evidence</u> for a coordinated effects theory of harm or even to articulate it clearly. It is at no point explicit as to which market participants it expects to coordinate over precisely what parameters, conceding that coordination not to enter the regions of rivals would not be "*perfect*". Neither does it credibly explain how a mechanism to manage such coordination would work nor how the Merger would make such coordination more likely. A serious examination of any of these points makes it clear that the theory of harm is unsustainable.

- The Phase 1 Decision is fundamentally flawed and was frustratingly based on a narrow and selective evidence base. At Phase 2, the CMA has the opportunity to review a wider range of evidence and address these flaws. In particular, the input of customers and greater analysis of the strategy and behaviour of competitors will be crucial. The Parties look forward to working with the CMA to demonstrate that this merger is pro-competitive and will bring substantial benefits for customers in its markets.

1 The Phase 1 Decision misrepresents the rationale for the Merger between the parties

1.1 YPO was established over 40 years ago by local government authorities to help combine their procurement demands and achieve efficiency savings. Its strapline: "Better value, delivered", remains the core of its objectives, to meet the needs of its local authority members' schools and the communities they are responsible for. To the extent that its activities generate a surplus, that surplus is returned to its associate members[1] and individual customers via 'dividends' or discounts, with any remaining amounts returned to local authority founder members. In all cases, that money supports front line services either through boosting the available money for individual customers or associate member authorities or by supplementing local authority budgets for founder members.

1.2 YPO is therefore an organisation with public sector values at its heart that was formed to deliver for its communities, but to do this successfully and deliver on its values, it has to operate efficiently and effectively in its markets, managing the YPO business competitively to drive value and innovation.

1.3 The strategic challenge which is met by the Merger, is as follows:

(a) to meet the needs of its customers, schools operated by its members and by others, it is essential for YPO to keep prices low;

(b) however the Parties' face an increasingly competitive market facing large existing competitors such as RM plc, ESPO and KCS, disruption from Amazon and different business models, such as that of Wall Family Europe (**WFE**), expansion from regional suppliers such as Herts Full Stop/Nottinghamshire County Supplies and constraints from specialist suppliers in each of their product categories (including by online specialists such as Office Depot Europe and Lyreco);

(c) changes in customer behaviour (such as the move to online, which facilitates shopping around and lends to increasing expectations around delivery times) accompanied with increased costs, mean that the Parties need to be more responsive to the increasing competitive landscape they are facing; and

(d) the incentive to keep prices low does not only come from YPO's public sector ethos or formal obligations as a public body,[2] but also the interests of its local authority members who need YPO to be low cost and efficient, making sure value is delivered to schools and communities and so allowing them to manage their increasingly stretched budgets.

---

[1] Associate members are local authorities which work with YPO (particularly on the other side of its business, procuring through public sector frameworks). In some cases the educational establishments linked to an associate member purchase from YPO, but have no obligation to do so. Associate members have no real role in the governance of YPO which falls to its founder members.

[2] YPO operates under the Public Services (Social Value) Act 2012 which requires it to factor in economic, social and environmental well-being in connection with its operating activities.

1.4 The strategic rationale of the Merger is therefore to realise efficiency gains by bringing two broadly complementary businesses together to allow a combined YPO/Findel to both (i) keep prices low; and (ii) gain efficiency to compete better and therefore avoid compromising the position of its member local authorities.[3]

1.5 Specifically, the acquisition of Findel:

(a) would be a pre-emptive move for YPO to better position a combined YPO/Findel to respond to changes in the traditional market dynamics (e.g. the move to online) and increasing customer sophistication (e.g. in employing professional buyers);

(b) will drive significant growth and aggregation in purchasing volumes, which typically allows for lower prices and better quality and service, all of which can be passed on to customers in line with YPO's mission; and

(c) will enable a combined YPO/Findel to unlock greater efficiencies and synergies throughout the combined operations, which are expected to lower cost even further and enhance service for customers.

1.6 The acquisition of Findel would allow YPO to make a step change in meeting increasing challenges in the market and deliver enhanced value much more quickly. In particular, it would bring together a variety of complementary features of the two companies, improving its combined offering to all of YPO and Findel's existing and future customers. For example, once integrated:

(a) YPO's customers will benefit from Findel's:

(i) strong digital offering;

(ii) superior product range in specialist categories (e.g. sports, science, early years) through the specialist side of its business; and

(iii) improved operational practices and levels of service, including its sourcing operation in the Far East;

(b) Findel's customers will benefit from YPO's:

(i) public service ethos, including its customer focus and pricing;

(ii) range of public sector frameworks, which include a wide variety of products and services (outside of the educational resources, but that schools also buy) not presently offered by Findel;[4] and

(iii) return of any surplus to its customers through its voucher scheme; and

---

[3] It would be both contrary to YPO's core function and politically difficult for its founder members for YPO to simply raise prices to react to reduced margins from increased competition. YPO has a single price list that is the basis for charging to all customers in all areas and a consistent discounting and promotional structure. There is no scope for it to differentiate between prices to state schools in the regions where its member local authorities are as compared with other schools. As a result, YPO is faced with a dynamic and competitive market reducing its margins whilst operating costs rise.

[4] These include negotiated frameworks for services such as energy, fleet, or food that are arranged for public bodies to access, but include products and services that schools need and buy.

(c) both sets of customers will benefit from:

(i) lower costs, driven by:

(A) increased purchasing volumes;

(B) rationalising warehousing;

(C) sharing/rationalising staff; and

(D) sharing fixed costs (e.g. catalogue production, professional fees); and

(ii) improved quality and service, driven by an amalgamated procurement process with greater volumes and pooled expertise to drive innovation, in particular by combining the Parties' digital capabilities. Given the clear evidence (explored below) that this is a major part of how schools interact with suppliers, increased capabilities and combined investment in this area are likely to drive significant innovation and competition with competitors, in particular Amazon Education.

1.7 At paragraph 27, the Phase 1 Decision cherry picks from internal documents to misrepresent this strategic balance. In doing so, the Phase 1 Decision has placed huge weight on three statements in internal documents stating that the merger is "*a relatively low risk route to increase market share*" and "*an exclusive opportunity to acquire its closest competitor*" and would "*consolidate YPO's position as the dominant market player*". However, when looked at in their full context, it is clear that these are selective quotations using language informally and non-technically and which are at odds with YPO's strategic rationale for the transaction as developed in the very same documents.

1.8 Certainly, YPO is seeking to improve its financial performance, against the backdrop of increased costs and competition but those same documents are clear that competitive pricing is and is intended to remain core to its strategy and its objective is to find a means to stay competitive in the face of commercial pressure. For example, the document made much of in the Phase 1 Decision and referenced at footnote 7 also says:

(a) "*To maintain the benefits to members described above, YPO must continue to operate a successful commercial model, producing competitive pricing and, at least inflation beating dividend on an annual basis*"; (emphasis added)

(b) "*YPO therefore needs to consider a step-change to its current operating model if the current benefits to members are to be maintained. The organisation faces increasing costs in running its operations and needs investment to compete in a market that is increasingly moving online and demanding quicker delivery. The launch of Amazon Business in our key education market indicates that these trends and demands are going to continue to grow. At the same time, YPO is determined to keep prices low to our customers - that is the reason that it was created in 1974 and drives everything that it does*."; (emphasis added) and

(c) Amongst the benefits of the acquisition the paper includes "*maintenance of competitive pricing in the face of rising costs to a broader range of public sector customers*."

1.9 ✄

1.10 It is therefore clear on the face of these documents that contrary to the selective quotes the CMA has chosen, there is no expectation of an ability to increase prices or compromise services as a consequence of the Merger, but rather, the imperative to improve financial performance would be realised through the efficiencies to be gained through the Merger.

2 Theory of harm 1: unilateral effects

Overview

2.1 The Phase 1 Decision has chosen to assess the Merger through an extremely narrow frame of reference of "supply of educational resources to Educational Institutions in the UK by Generalist Distributors". In doing so, it has therefore given minimal weight to many regional and local Generalist Distributors who are important in their own regions and little or no weight to distributors that it regards as "out of market", some of whom are of substantial scale and ambition, such as Amazon and WFE.

2.2 Even if the findings in the Phase 1 Decision are accepted at face value, this is a 4.5-3.5 merger and therefore not one that should, absent other considerations, be expected to result in an SLC. The CMA finds that post-merger, the Parties will be fully constrained nationally by two others (one, RM plc that is a UK plc and the other, ESPO that is a public organisation) and a third, KCS that partially constrains them.[5]

2.3 The Phase 1 Decision also seeks to suggest that Findel represents a particularly strong constraint as a "maverick" in the market and that the Merger therefore results in the loss of a particularly important and destabilising constraint.[6] However, there is no particular evidence that Findel is a particularly more aggressive competitor compared to any of the many other competitors in this space. Findel has the same public sector origins as other Generalist Distributors, and there are no grounds to regard it as a materially more aggressive competitor than, say, RM plc, currently the largest market participant which began as a public sector organisation that transitioned to the private sector. The real disruption in this market has come from Amazon and the switch to online. Findel is not unusual in having sought to grow, or to find ways to differentiate itself against this backdrop. Findel has, in some respects, such as its online offer, been quicker to adapt in responding to this disruption (rather than acting as a disruptor itself). However, all distributors have sought to adapt and develop their offers to do this. Whilst YPO took a different strategic route to Findel, managing the risks to its business by partnering with Amazon, to limit customer losses in the short term and to learn from that partnership, it has invested over ✄ in re-forming its website to offer increased functionality and service to its customers and moved to next day delivery services to be more responsive to customer needs.[7] In practice, far from being a particularly close, or disruptive competitor to YPO, Findel is in many respects complementary (for example in its geographic footprint). Far from Findel "pricing aggressively", it is YPO which tends to be at the lower end of the pricing spectrum with Findel more expensive.

2.4 The Phase 1 Decision adopts an implausibly narrow frame of reference, rejecting a very wide range of suppliers as forming either in-market or out of market constraints. These suppliers and the constraints they impose are discussed further below. Crucially, all these suppliers sell the

[5] Paragraphs 128, 161 of the Phase 1 Decision. Though we note that in Table 1 WFE is included as a Generalist Distributor, but is elsewhere dismissed as an out of market Specialist Distributor that does not act as any form of constraint.

[6] Paragraphs 279-281 of the Phase 1 Decision.

[7] As the CMA is aware from the response to the Issues Letter at Paragraph 3.58, RM plc also responded to this pressure, including by consolidating warehouses to increase service capability and lower costs.

same kinds of products, to the same educational establishments in the UK, for the same uses as the products sold by the Parties.

2.5 Consequently, for the unilateral effects theory of harm set out in the Phase 1 Decision to be plausible, it is critical that customers buy primarily on a "one stop shop" basis, and that the boundary between core purchases and other purchases is fixed. Unless a supplier can charge different prices for purchases made as part of 'one stop shops' and purchases made as 'top up shops', then competition for top up purchases will constrain all prices. The greater the proportion of top up purchases, the stronger this constraint will be, since the supplier does not want to risk losing a non-trivial share of volumes by pricing higher to exploit the demand for a 'one stop shop'.

2.6 However, neither of these assumptions hold true on the evidence and indeed, that is reflected in the Phase 1 Decision, which acknowledges that there is top-up shopping,[8] that schools typically buy from multiple suppliers[9] and that the boundary between Specialist and Generalist suppliers is not clear cut.[10]

2.7 We have considered in more detail below:

(a) the very wide range of market participants and constraints that the parties face and which have not been given weight in the Phase 1 Decision;

(b) the lack of any basis to regard Findel as a "maverick" that acts as a unique, disruptive or particularly close constraint; and

(c) the evidence relating to customer shopping behaviour and how that is changing.

The Phase 1 Decision adopts an implausibly narrow frame of reference and fails to give weight to substantial constraints from inside and outside the market

2.8 The Phase 1 Decision reviews a very wide range of suppliers that sell the same kinds of products, to the same educational establishments in the UK, for the same uses as the products sold by the parties, but does not give them weight as constraints on the parties:

(a) *National Generalist Distributors*:

(i) The Phase 1 Decision recognises RM plc (currently the largest supplier in the market) as a true national constraint on the Parties. In each of the regions where the Phase 1 Decision expresses concern (other than Scotland), RM plc is a significantly stronger competitor to the larger of the Parties in that region than the other. It also recognises strong constraint from ESPO and lesser constraint from KCS which it terms smaller regional distributors.[11] In reality, both of these generalist distributors are credible, strong, national competitors. Developments even in the last few weeks demonstrate this. RM's recent half year results presentation describes it as focusing on innovation and technology

[8] Paragraphs 97, 101 Phase 1 Decision.

[9] Paragraph 182 of the Phase Decision even states that "*schools would typically get most of their supplies from two to five suppliers for the bulk of their supplies and use two to three Specialist Suppliers if they require specialist items*. This key evidence is inexplicably not considered in the assessment of customer behaviour and preferences at paragraphs 95-115, the Phase 1 Decision.

[10] Paragraph 54, Phase 1 Decision.

[11] Phase 1 Decision, paragraph 83.

(including pressing ahead with consolidating its four distribution centres into a single automated facility).[12] ESPO has also this month launched a national cashback rewards partnership with Sainsbury's and Argos for individuals to claim rewards for schools.[13] This demonstrates both creativity and ambition on ESPO's part in finding new routes to market. ESPO (which markets itself as the largest public sector buying organisation in the UK) ought properly to be recognised for the national player that it is. COVID-19 has prompted greater focus on online sales. KCS in particular has launched a national online campaign (including via social media) targeting home schooling parents during the Covid-19 pandemic.[14]

(ii) The Phase 1 Decision entirely discounts WFE, a group including a range of businesses each of which has been established in various segments of the UK educational resources market and have been brought together under common ownership in recent years. This is a different model to other Generalist Distributors, however WFE earns a very substantial revenue (£37 million) from schools in the sector and where its sales are made and what they comprise by comparison with those of others in the market requires closer examination. In particular, similar to Findel, WFE operates a number of businesses with their own brands which supply schools in competition with the Parties. Customers may not necessarily recognise 'WFE' but would certainly recognise its individual brands and taken together, they are a significant constraint. It will be important during the Phase 2 inquiry to ensure that these nuances are properly accounted for and that the full set of competitive options considered by customers is taken into account.[15]

(b) *Regional and local Generalist Distributors*: the Phase 1 Decision acknowledges a number of such distributors (Herts Full Stop/Nottinghamshire County Supplies, East Riding) but gives them no weight, even though it recognises that, for example, in the Yorkshire and Humber region in which it operates, East Riding's sales amount to around [10-20]% of all sales by Generalist Distributors.[16] This is substantially greater than Findel's share in the same region. The Phase 1 Decision also recognises that the Parties track, monitor and benchmark against these competitors (and in particular Herts Full Stop and East Riding).[17] However, by building its market share data on BESA sales data and by capturing only the largest participants, as it does in Table 4, it entirely misses the constraints posed by such distributors. A large number of distributors specifically identified by the Parties were not even assessed in the Phase 1 Decision.[18] To dismiss even the local significance of such distributors because they do not feature frequently in national survey evidence or in the totality of internal documents, as the Phase 1 Decision does,[19] is misleading as it ignores the constraint each may have

---

[12] See investor presentation available here: https://www.rmplc.com/announcements .

[13] See: https://www.espo.org/Spotlight/News-And-Articles/2020/My-School-Fund-launch

[14] See http://www.kcs.co.uk; https://www.kcs.co.uk/community/back-to-school and https://www.kcs.co.uk/community/kcs-supporting-families-home-learning.

[15] It is worth noting that the coordinated effects theory of harm set out in the Phase 1 Decision also relies on data from WFE being submitted to BESA (paragraph 247 of the Phase 1 Decision). Whilst the Parties reject this theory of harm in the strongest possible terms, the CMA's position in ignoring WFE as an inconsequential player in considering unilateral effects is entirely inconsistent with its theory of harm as to coordinated effects.

[16] Paragraph 211, Phase 1 Decision.

[17] Paragraphs 137 and 145, Phase 1 Decision.

[18] Paragraph 171, Phase 1 Decision.

[19] See for example paragraphs 167-169 of the Phase 1 Decision.

locally or regionally and does not give weight to the importance of the constraint from such distributors in aggregate.

(c) *Specialist Suppliers*: the Phase 1 Decision dismisses Specialist Suppliers as a constraint, amongst other reasons because customers rely on Generalists as a "one stop shop"[20] and that Specialist Suppliers sell product categories that sit outside of what most Generalists would supply.[21] However, for every product category sold by the Parties, there are numerous Specialist Suppliers which also supply the same type and range of products in that category.[22] In order to constrain the Parties, it is not necessary for such Specialists to operate in every single category, only that educational establishments consider these Specialists as an alternative to some of their requirements. The Parties' believe this is absolutely the case and requires further examination in Phase 2. Contrary to the conclusion the Phase 1 Decision seeks to draw at Paragraph 183, a 2% decline in revenue (not inflation adjusted) over 4 years for the Generalist Distributors is not "*fairly stable*" but rather an indication of significant challenge to the existing operators and significant competitive tension across product ranges.

(d) *Amazon*:

(i) The Phase 1 Decision dismisses the constraint from Amazon based on a backward looking view that does not take into account the substantial recent investment and effort that Amazon has put into the market and is described at 3.52-3.56 of the Parties' Response to the Issues Letter. It also ignores the significant investment undertaken by the Parties and their competitors, evident from the Parties' internal documents, in respect of their digital offerings and the resulting shift in the market norm. As the CMA is aware, ✄.[23] The reference at Paragraph 193 of the Phase 1 Decision to "*top suppliers….through Amazon*" (emphasis added) in order to support the premise that Educational Institutions are buying different products from those they buy from Generalist Distributors suggests that there may be some confusion between direct sales by Amazon (which it is driving hard) and sales by third parties through the Amazon Marketplace. The Parties are particularly concerned by this possibility as the CMA seems to be relying on evidence from third party sources not put to the Parties during the Phase 1 procedure. Again, this requires further, careful examination at Phase 2 (in particular, the CMA has the power to require Amazon to provide information/documents relating to the current/historical performance of Amazon Education and relating to its strategy/business plans going forward).

(ii) It is worth noting that the fierce online competition from competitors across the board has only increased during the Covid-19 pandemic and following the re-opening of schools. Competitors such as RM Plc, KCS, ESPO and Early Years Resources have all launched online 'back to school' marketing campaigns, in

---

[20] Paragraph 179, Phase 1 Decision.
[21] Paragraph 182, Phase 1 Decision.
[22] See Table 1 of the Parties' response to the Issues Statement.
[23] Response to the Issues Letter, Figure 5.

some cases including via social media.[24] Indeed, YPO's percentage of sales made online have ✄.

2.9 Ultimately, the CMA's failure to recognise any constraint, even in the aggregate, from a very wide range of other providers that sell products to schools which the parties also sell is implausible. These include more 6 additional generalist suppliers but also WFE, which operates under a different business model but at a scale comparable to the parties and more than 40 specialist suppliers all of whom can displace some element of sales made by the parties. In reality, the number is much larger with the full competitor set totalling more than 200 generalists, specialists and manufacturers supply schools directly.[25] A number of these, in their different ways, including ESPO, KCS, Amazon, Herts/Notts (through their collaboration) have ambition and capability to expand significantly and have done so recently. For example, ESPO, KCS and Herts have all made acquisitions in the last two years and KCS and WFE have both expanded their business units to include additional offerings for customers.

2.10 Further, the Phase 1 Decision does not take account of the substantial sales made to Educational Institutions by manufacturers directly in competition with the Parties in particular product categories. This additional constraint ought to be explored at Phase 2.

Findel is not a unique, disruptive or particularly close constraint to YPO

2.11 The Phase 1 Decision seeks to suggest that Findel represents a particularly strong constraint as a "maverick" in the market and that the Merger therefore results in the loss of a particularly important and destabilising constraint.[26] However, Findel has the same public sector origins as other Generalist Distributors, and is no different to RM plc, currently the largest market participant which began as a public sector organisation that transitioned to the private sector. Far from Findel "*pricing aggressively*", YPO tends to be at the lower end of the pricing spectrum and Findel slightly more expensive. Findel is not unusual in having sought to grow, expand beyond its region or to find ways to differentiate itself. The Phase 1 Decision simply assumes this is the case from customer and sales data within the YPO and Findel businesses, but does not interrogate, for example, the development of RM plc, WFE or of others who have sought to expand. In practice YPO will show that, far from being a particularly close, or disruptive competitor to YPO, it is in many respects complementary (for example in its geographic footprint).

Customers buy from a range of sources, switch spend frequently and divert to a range of specialist and generalist suppliers

2.12 The CMA has misunderstood customer behaviour and mischaracterised customers as 'sticky' and incapable/lacking motivation to 'shop around'.

2.13 The CMA has overstated customer reliance on 'one-stop shop' distributors again by selective reliance on only two documents and seemingly inconsistent and limited evidence from third parties.

---

[24] For KCS, this also follows an online campaign (including via social media) targeting home schooling parents during the Covid-19 pandemic as set out in footnote 14, above.

[25] Following the CMA's Issues Letter, YPO commenced further work with its sales staff to establish a more comprehensive set of competitor details. This has continued into the phase 2 investigation and a more detailed list will be provided in response to the CMA's s.109 Notice.

[26] Paragraphs 279-281 of the Phase 1 Decision.

2.14 The CMA has gathered evidence from third party sources which indicates that Educational Institutions favour placing bulk orders to avoid multiple deliveries.[27] However, taken alone, that simply indicates that customers wish to avoid multiple deliveries (e.g. of the same or similar products). It does not of and by itself support the contention that Educational Institutions prefer to buy all or most of their supplies from one supplier as a one-stop shop and do not switch between them. In fact, the evidence gathered by the CMA refers to only one third party (which does not appear to be a customer) which has specifically stated that *'schools often purchase the majority of educational resources from one (or 2)'* distributors.[28] Given the large number of customers which the Parties and competitors service, engagement with the right people at customers will be critical.

2.15 The CMA also relies on internal documents of the Parties. However, these documents must be considered in the round; the YPO 'Long Tail Strategy' document relied upon by the CMA to conclude that YPO's model is based around being a one stop shop[29] begins with its opening paragraph stating that YPO struggles to be able to make that claim due to the market changes brought about by online competition.

2.16 In mischaracterising this evidence, the CMA has dismissed the Parties' data which demonstrates that:

(a) a large number of customers purchase from a small number of product categories;

(b) there is variation in the preferences for categories when only a few categories are bought; and

(c) customers change their purchasing behaviour from one year to the next.

<u>A large number of customers purchase from a small number of product categories</u>

2.17 The Phase 1 Decision states that *'Educational Institutions have a preference to procure the bulk of their educational resource requirements from a single or a small number of distributors, ie favouring a one-stop-shop approach to purchasing'*.[30] The Phase 1 Decision also states that *'The majority of large customers (by spend) purchase across a large number of broad categories'*.[31] Although these are crucial assumptions underlying the Phase 1 Decision, these conclusions are not supported by the Parties' sales data. Conservatively assuming that within a given month a customer only places one order, the Parties' sales data show that customers typically purchase only a few product categories in each order. This is contrary to the Phase 1 Decision's view that customers, and especially large ones, have a strong preference for bulk orders and a one-stop-shop approach.

2.18 Figure 1 below shows the number of product categories purchased by YPO's and Findel's customers within the same month in 2019. Almost half of YPO's customers purchased products from only one or two categories within the same month in 2019. Over the last four years, the share of customers purchasing from at most two categories in the same month has increased

[27] Phase 1 Decision, paragraph 98.
[28] Phase 1 Decision, footnote 108. This itself is inconsistent with the finding at paragraph 182 of the Phase 1 Decision, which states that schools use two to five suppliers for the bulk of their supplies and two to three Specialist suppliers where they require specialist items.
[29] Phase 1 Decision, paragraph 99(a)(i).
[30] Paragraph 95 of the Phase 1 Decision.
[31] Paragraph 100 of the Phase 1 Decision.

from ✂% in 2016 to ✂% in 2019. ✂ of Findel's customers purchased from only one or two categories. Similarly to YPO, the share of Findel's customers purchasing from at most two categories within the same month has increased since 2016 (from ✂% in 2016 to ✂% in 2019).

Figure 1: ✂

2.19 These results are also reflective of the position of the Parties' largest customers – defined as top 30% customers by annual spending. The Parties' sales data show that the majority of large customers (✂% of YPO's customers and ✂% of Findel's customers in 2019) purchase at most four categories within the same month. Over the last four years, the share of customers purchasing at most four categories within a single month has increased from ✂% in 2016 to ✂% in 2019 for YPO and from ✂% in 2016 to ✂% in 2019 for Findel. Only ✂% of YPO's largest customers and ✂% of Findel's large customers purchased more than five product categories within the same month in 2019.

<u>There is variation in the preferences for categories when only a few categories are bought</u>

2.20 The Phase 1 Decision states that specialist competitors impose a *'limited constraint on the Parties'*[32] as these can only offer customers a more limited range of products compared to Generalist Distributors.[33] As shown in Figure 1, this conclusion is not supported by the analysis of the Parties' sales data: a material proportion of the Parties' customers purchase only one category at the time. Furthermore, as shown in Figure 2, customers purchasing one category do not have strong preferences for specific product categories. Thus, specialist suppliers offering single product categories can compete with the Parties independently on the specific product category they supply.

Figure 2: ✂

<u>Customers change their purchasing behaviour from one year to the next</u>

2.21 The Phase 1 Decision states that *'Educational Institutions are generally loyal customers and do not switch their main Generalist Distributors or shift large amounts of spend frequently'*.[34]

2.22 First, the Parties notice that Findel's average customer tenure is only ✂ years and YPO's average customer tenure is only ✂ years. This evidence is not consistent with customers being particularly loyal, especially if considered that YPO has been operating in the market for the last 45 years.

2.23 Second, the analysis of the Parties' sales data show material variations in the customer expenditure from year to year. Figure 3 and 4 below show the distribution of the Parties' existing customers' year-to-year expenditure variation between 2018 and 2019. ✂% of YPO's and ✂% of Findel's customers in 2018 decreased their spending with YPO and Findel respectively by at least 30% or stopped purchasing from the Parties in 2019. ✂% of YPO's and ✂% of Findel's customers in 2018 did not purchase any product from YPO/Findel (as relevant) in 2019. Should customers be sticky, we would expect expenditure to be much more stable from one year to the

---

32 Paragraph 175 of the Phase I Decision.
33 Paragraph 179 of the Phase I Decision.
34 Paragraph 95 of the Phase 1 Decision.

next. That would imply that the bars closest to the vertical line (indicating no change in expenditure across years) would be much higher than those further away.

Figure 3: ✄

Figure 4: ✄

2.24 The results are consistent when considering only the Parties' largest customers – defined as the top 30% customers by annual spending. Almost ✄% of YPO's and ✄% of Findel's largest customers in 2018 decreased their spending with YPO and Findel respectively by at least 30% or stopped purchasing from the Parties in 2019.

2.25 These results are entirely consistent with the realities facing Educational Institutions. Far from the CMA's characterisation of them as lacking in incentive to shop around, Educational Institutions have limited budgets and those tasked with purchasing supplies are tasked with maximising those budgets.

2.26 Finally, the CMA has not expressly set out what the actual effect of the horizontal unilateral effects it believes may arise would be (i.e. whether it would be reduced service levels or increased pricing or both). The Parties' view is that in the highly competitive space that they operate, any decrease in service levels or increase in prices would result in significant loss of revenue. This is reflected in YPO's internal business case for the transaction. In particular, given the clear commitment to not increasing prices made by YPO in both its strategic and financial business cases and the stated requirements of good service from customers evident in the CMA's phase 1 decision, it is difficult to see how unilateral effects could in fact arise.

3 Theory of Harm 2: 'coordinated effects'

3.1 The Parties are incredulous that the Phase 1 Decision has pursued an ill-founded and illogical coordinated effects theory of harm. The CMA has failed to provide evidence for a coordinated effects theory of harm or even to articulate it clearly. It is at no point explicit as to which market participants it expects to coordinate over precisely what parameters, conceding that coordination not to enter the regions of rivals would not be "*perfect*".[35] Neither does it credibly explain how a mechanism to manage such coordination would work or how the Merger would make such coordination more likely. A serious examination of any of these points makes it clear that the theory of harm is unsustainable.

3.2 The Phase 1 Decision, sets out four key propositions to advance this theory of harm:

(a) that there is evidence of pre-existing co-ordination in the market;

(b) that Generalist Distributors would have the ability to collectively reach and subsequently monitor independently, the terms of their coordination;

(c) that this coordination would be internally sustainable, i.e. sufficiently profitable for all players involved; and

---

[35] Phase 1 Decision, paragraph 265.

(d) that this coordination would be externally sustainable, i.e. not liable to be disrupted by external competitors outside of the coordination.

3.3 The evidence set out in the Phase 1 Decision does not support these propositions.

There is no evidence of pre-existing coordination in the market as it stands today

3.4 The Phase 1 Decision characterises a number of benign and normal behaviours as evidence of coordination:

(a) communication between PSBOs including through collaboration on Framework Agreements. The CMA nevertheless concedes that there may be valid reasons for such collaboration. [36] In focusing on Framework Agreements, the Phase 1 Decision misunderstands their nature, which is that they relate to activities that are on a different side of YPO's business and are only tangential to the market for educational resources. PSBOs collaborate to create Framework Agreements for products and services that local authority services might need and which schools might also benefit from – for example, energy, fleet, catering.[37] These are not matters that require or involve contact in relation to educational resources; and

(b) communication through BESA. Why the Phase 1 Decision accords such significance to BESA and the market data gathering it conducts is unclear. BESA is ultimately a trade association, like many others, comprising both private sector and public sector operators, working together on matters of legitimate common interest. The role of BESA in collecting and disseminating data to monitor industry trends and growth are standard practice for trade associations. BESA follows best practice guidelines for the exercise, using an independent third party (C3 Education) to receive the data and to aggregate it across a sufficiently large group of suppliers (including specialist suppliers), such that no recipient can ascertain the data of any other individual supplier. Further, the BESA data is only provided at a national level and as such cannot be used to track/monitor regional developments in the market, of particular relevance to a theory of harm based on a concern of regional coordination.

3.5 In looking to evidence pre-existing coordination, the Phase 1 Decision gives significant weight to the informal investigation of the Office of Fair Trading (**OFT**) in 2011 (almost a decade ago) into the supply of goods and services to schools. The OFT did not open a formal investigation or make a finding of an infringement, and the series of undertakings provided to the OFT were positive steps by the industry to ensure compliance and improve competitive conditions.

3.6 The Parties believe that the CMA's present concerns may stem from the fact that the PSBOs tended, for historical reasons, to hold strong positions in their original areas. In the CMA's eyes, this has not changed significantly since 2011 and therefore the CMA erroneously concludes there is a risk of present co-ordination. However, the market has changed and is changing hugely. As explained previously, the PSBOs are much more commercial in their operations whilst seeking to uphold public sector values. Several of them have completed strategic mergers and all target customers well beyond their original areas, as evidenced above. The PSBOs all (without exception) compete in the heartlands of other PSBOs. We have demonstrated above the intensity of competition which exists between PSBOs themselves and between them and

[36] Phase 1 Decision, paragraph 242.

[37] See https://www.ypo.co.uk/frameworks-home for the frameworks YPO currently offers.

the broad array of competitors who compete at a national and regional level in the supply of educational resources. The highly competitive nature of the market means it would not be feasible for the PSBOs to reach or maintain coordination between them for supply of educational resources.

In a market with many customers and many participants, there is no ability to reach and monitor coordination

3.7 The Phase 1 Decision is unclear as to who would be expected to coordinate and how they would arrive at such coordination. Its focus is on PSBOs, but any successful coordination would also need the participation of RM plc. It also concedes, though seeks to argue that this could be achieved, that there would also need to be coordination at local and regional level, where there are strong competitors in those geographic areas.[38] However, this introduces a high degree of complexity, even without taking into account the role of Specialist Suppliers and Amazon.

3.8 Coordination among Generalists alone would be ineffective when so much competition is provided by specialists, regional and online only businesses. It is unrealistic to imagine that a critical mass of competitors in this market could reach consensus and efficiently coordinate, monitor and punish non-coordinated behaviour across tens of thousands of products.

3.9 The Phase 1 Decision assumes that coordination can be monitored and sustained by ad hoc market intelligence on the sales and marketing activity of rivals; through existing, legitimate contacts, discussed at paragraph 3.4 above and through monitoring of their own monthly category share data circulated by BESA.[39] However, all of these channels fall far short of providing transparency levels to sustain coordination in a market with thousands of products and many thousands of customers. Further, even if information on individual educational establishments spending decisions could be obtained on a granular level, that data is so volatile that data cannot be interpreted with sufficient transparency to sustain coordination.

3.10 By way of example, customer purchase data shows that it is not uncommon for the expenditure of a school with YPO or Findel to change significantly from one year to the next (looked at on a like for like basis that takes account of the buying seasons in the school year). It is not credible that so many changes could be identified and followed up where there is switching behaviour.

3.11 Many such decisions are made across thousands of schools and the imperfect and the ad hoc market intelligence gathering the Phase 1 Decision proposes as mechanisms for coordination stretch are simply not plausible to perform that role.

3.12 Finally, by underestimating the competitive constraints, the CMA has overstated the impact that the removal of Findel would have on potential coordination. Although the Parties reject the CMA's assessment of the competitive landscape (as described above) if the CMA's assessment of the competitive constraints on the Parties is correct, then it does not necessarily support the contention that removing Findel would lead to greater coordination. In those circumstances, the CMA would need to take account of the fact that where competition is more limited, there are credible market-driven reasons for market players' decisions which do not rely on coordination. In this case, the history of the sector and market players' origins are the real reason for any historic heartlands existing and continuing to do so simply reflects reality, not necessarily coordination.

---

[38] Phase 1 Decision, paragraph 266.
[39] Phase 1 Decision, paragraph 268.

Coordination is not internally sustainable

3.13 The Phase 1 Decision wrongly considers that coordination is internally sustainable as, if formed, deviation would be easily detected, as sales and marketing activity would be identified and that deviation is unlikely to be profitable, because customers cannot easily be gained.[40] However, as discussed above, neither assumption is true. Market participants of all kinds can and do market widely, selling well outside of their "heartlands" and the ad hoc information available gives little indication of the scale or success of such activity. Customers can and do vary what they spend and who they choose to spend it with. Demand is not stable as the Phase 1 Decision assumes[41] and can be readily disrupted. For example, the current COVID pandemic has changed the resource requirements of Educational Institutions as they have adapted how they deliver education during the crisis. These changes are likely to persist into the medium and longer term and are yet to be fully understood.

3.14 There is also a strong internal tension between the Phase 1 Decision's view that "*expansion is risky, costly and visible with limited chances of success*"[42] (which, for the avoidance of doubt, the Parties do not accept is the case) and the belief that there are incentives to coordinate in the first place, or that market participants can effectively punish a deviating firm and indeed the Phase 1 Decision concedes that punishment through discounting and targeting rivals' customers may have limited impact.[43]

3.15 Finally, the asymmetry in size of market participants would have a significant negative effect on their incentives to coordinate. The different size of educational suppliers makes it difficult to align their incentives. Since the merger increases this asymmetry, the likelihood of sustainable co-ordination is lowered further.

Coordination is not externally sustainable

3.16 The CMA's implausibly narrow frame of reference mischaracterises the market as much more concentrated than it is. For the reasons set out in response to Theory of Harm 1, there are substantial competitive constraints from a very wide variety of suppliers that would also disrupt any attempted coordination.

4 Conclusion

4.1 The Phase 1 Decision is fundamentally flawed and was frustratingly based on a narrow and selective evidence base. It is clear that the Phase 1 process included insufficient engagement with customers and insufficient examination and consideration of the business models and activities of others in the market.

4.2 At Phase 2, the CMA has the opportunity to review a wider range of evidence and address these flaws. In particular, the input of customers and greater analysis of the strategy and behaviour of competitors will be crucial. The Parties look forward to working with the CMA to demonstrate that this merger is pro-competitive and will bring substantial benefits for customers in its markets.

---

[40] Phase 1 Decision, paragraph 276.
[41] Phase 1 Decision, paragraph 277.
[42] Phase 1 Decision, paragraph 283.
[43] Phase 1 Decision, paragraph 286.